**MEMORANDUM**

**DATE: May 11, 2020**

**TO: Mayor, Council President and Councilmembers**

**FROM: Tim Johnson**

**SUBJECT: Gross Domestic Product**

Last week, the U.S. Department of Commerce, through the Bureau of Economic Analysis, identified that the Gross Domestic Product, (GDP) fell 4.8% in the first quarter of 2020. This figure along with unemployment numbers at the federal and state level provides further insight into the deep damage the coronavirus has brought on the economy.

This decrease marked the first negative GDP reading since the 1.1% decline in the first quarter of 2014 and the lowest level since the 8.4% plunge in the fourth quarter of 2008 during the Great Recession.

To better understand the impact, the value of the US GDP at the end of 2019 was $21.5 trillion, the largest in the world. Given the estimated decline of 4.8 percent, it equates to a loss of just over $1 trillion in current dollars to the economy.

Consumer expenditures, which typically comprise two-thirds of the total value of the GDP, plunged 7.6% in the first quarter as all nonessential stores were closed taking out most retailing in the nation. Spending on durable goods, such as cars, furniture and appliances tumbled 16.1% while expenditures on services, such as health, personal and professional services were down 10.2%.

Exports dropped 8.7% while imports fell 15.3%, including a 30% drop in services.

Most economists already see the nation in a recession even though the technical definition is generally two consecutive quarters of negative growth. This view is largely shared because the first-quarter numbers while they only include a few weeks of the economic shutdown brought about by the coronavirus probably underestimate the real damage and their future impacts.

The Bureau of Economic Analysis which is the federal agency that calculates the GDP pointed out in a technical note last week that when it released the GDP the initial reading was probably inaccurate.

*“The coronavirus lockdown “led to rapid changes in demand, as businesses and schools*

*switched to remote work or canceled operations, and consumers canceled, restricted, or*

*redirected their spending. The full economic effects of the COVID-19 pandemic*

*cannot be quantified in the GDP estimate for the first quarter of 2020 because the*

*impacts are generally embedded in source data and cannot be separately identified.”*

When the Bureau of Economic Analysis makes its revisions to the initial GDP reading, the results could show an increased decline. Such was the case during the Great Recession. The first estimate for fourth quarter of 2008 was a drop of 3.8%. However, by the revised release, it had more than doubled by the time the government went through all the numbers and the subsequent revision.

BACKGROUND

You will undoubtably read more about the GDP in the near future as it pertains to the calculation of a recession and when it began due to the coronavirus. So, the additional value of this memo is to provide relevant information and insight for a better understanding of the GDP at the national, state and local level.

Therefore, in the effort to understand the GDP, the following presents a short explanation.

The GDP is the total value of all final goods and services produced in an economy, within a country's borders.  Over the years, economists in the nation calculated and used the term Gross National Product, GNP as well. The United States government stopped using that equation in 1991, in favor of the globally preferred GDP equation.

A GDP is calculated by incorporating four elements. These include: Consumption, Investment, Government Spending and Exports minus Imports. Below is the distributive equation used to calculate a GDP.

GDP = C + I + G + (X - M)

“C” stands for consumption. It consists of private expenditures of households in the economy. It typically makes up two-thirds of the economy. The consumption expenditures include three categories: Durable Goods includes items such as cars, furniture and appliances. Non-Durable Goods include items such as food and gasoline. Services includes items such as medical, educational and personal and professional services.

“I” stands for investment. It includes business investment such as the purchase of assets but does not include exchanges of existing assets such as property or equipment. “Investment” in GDP does not mean purchases of financial products. It is important to note that buying financial products is classed as ‘saving,’ as opposed to investment.

“G” stands for government spending. It is the sum of government expenditures on final goods and services. Transfer payments made by the government are not counted because these payments do not reflect a purchase by the government, rather a movement of income. They are captured in “C” when the payments are spent.

“X” stands for (exports). This category captures the amount a country produces, including goods and services produced for other nations’ consumption. “M” stands for (imports) and is subtracted from exports.

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The same equation can be applied to states and counties. It can also be applied to cities; however, it requires significant research and may be void of base-data specifically regarding sources on exports and imports.

However, according to the Bureau of Economic Analysis, Washington State had a GDP of $610.5 billion at the end of 2019. Washington had the highest GDP percentage growth rate in the nation at 3.4% in 2019. Significantly important is that Washington’s GDP has been growing at 6%-8% per year over the last 3 years which is much greater than the national average. Specifically, in the fourth quarter of 2019.

Recall in the economic development framework, “Prosperity Beckons,” it was identified that King County had the 6th largest GDP by county in the nation in 2018. The pent-up demands of consumption in both the state and county could bode well in the return of a future full operating Federal Way economy. Also,

Economic development has been examining savings. Preliminary information illustrates that it is possible that Americans, including Washingtonians may have been saving beyond national averages. A future report will examine that information and the future for recovery.

SUMMARY

Our nation does not make it easy for people to follow economics and corresponding performance measures and who is responsible for them.

For example, the Bureau of Economic Analysis which is a federal agency within the Department of Commerce calculates and presents the quarter and year ending data for the nation’s, states and counties GDPs.

Meanwhile, another organization with a similar name, the National Bureau of Economic Research, a private non-profit organization, determines the beginning and end of recessions.

It is confusing, but city staff is here to support your efforts. Should you have any questions, we are available at your convenience.

Assistance was provided to this memo by Soham Ghose, a graduating senior in quantitative economics at the University of Washington. Soham is an economic development intern for the City of Federal Way. Soham was born and raised in Bangalore, India. He is fluent in Hindi, Bengali and English and has basic fluency in Spanish and French. He previously worked for Arab Financial Services in Bahrain.